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Payment Limits for Farm Commodity Programs: Issues and Proposals

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Summary

Payment limits set a maximum amount of farm commodity program payments per person. Limits were created in 1970 and continue today. Federal deficits and perceived inequities in the distribution of payments have heightened congressional attention. Many observers expect the 110th Congress to debate payment limits as part of the 2007 farm bill, during an overall consideration of the distribution and effect of subsidies.

Tighter limits would likely affect more southern cotton and rice farms than midwestern feed grain and oilseed farms. Fewer acres of cotton or rice are needed to reach the limit since payments per acre generally are higher. This report will be updated.

Background on Payment Limits

Payment limits set a maximum amount of farm program payments a "person" can receive (7 U.S.C. 1308). Limits have existed since the Agricultural Act of 1970 (P.L. 91-524). The issue was controversial when the 2002 farm bill was written (the Farm Security and Rural Investment Act, P.L. 107-171, Section 1603), and the policy debate continues today. The debate usually focuses on what size farms should be supported, whether payments should be proportional to production or limited per individual, and the need to reduce federal spending.

The effect of payment limits varies greatly across individuals and regions. The South and West have more large farms than the Upper Midwest or Northeast. By commodity, cotton and rice farms are affected more often since subsidies per acre are relatively higher.

What Payments Are Subject to Limits? Producers generally receive three types of payments: direct payments, counter-cyclical payments, and marketing loans. Applying payment limits to direct and counter-cyclical payments is relatively straightforward, since they are direct cash transfers. Marketing loans are more complicated because limits do not apply to some marketing loan options (see CRS Report RL33271, *Farm Commodity Programs: Direct Payments, Counter-Cyclical Payments, and Marketing Loans*, by Jim Monke).

The following types of payment are subject to limits:

- Direct payments
- Counter-cyclical payments
- Some marketing loan benefits
  - — marketing loan gain (MLG): repaying a loan for less than the original amount and keep the difference as a marketing loan benefit
  - — loan deficiency payment (LDP): making a cash payment instead of taking out a loan

Payments not subject to limits include:

- Some marketing loan benefits
  - — commodity certificate gain (similar to MLG): repaying a loan with certificates instead of cash (P.L. 106-78, § 812, exempted commodity certificates)
  - — forfeiting the collateral (commodity) and keeping cash from the loan

Other farm programs have payment limits per person. These include the Milk Income Loss Contract (MILC, 2.4 million pounds of milk annually), Conservation Reserve Program ($50,000), and Environmental Quality Incentives Program ($30,000).

Who Receives Payments? One-third of the 2 million farms in the United States receive subsidy payments, although the ratio is as high as 72% in North Dakota and 70% in Iowa. Ten states received 53% of the total amount (Texas, Iowa, Georgia, Arkansas, California, Illinois, Nebraska, Minnesota, Kansas, and Mississippi). About 708,000 farm operators and 998,000 landlords received payments, with operators accounting for 54% of payments. Half the payments went to 5% of recipients (see CRS Report RL32590, *Average Farm Subsidy Payments, by State, 2002*, by Jasper Womach). In addition to individuals, certain corporations, partnerships, and trusts are eligible. The impact of limits can be minimized legally by creating multiple entities to receive payments.[1]

How Many Farmers Are Affected? Little data are available on the current effect of payment limits. The 2003 report of the Payment Limits Commission provided data relevant to one of the three current payments. In 2000, about 1% of producers receiving payments were affected by the $40,000 limit on what now are called direct payments.[2] This amounted to 12,300 producers across 42 states. The total reduction in direct payments was $83 million, or 1.6% of the total. Payment reductions in California ($19.6 million) and Texas ($10 million) represented 36% of the total reduction. Reductions to cotton farmers accounted for 60% of the cut in California and 35% of the cut in Texas.

In December 2006, USDA released a new database that attributes payments to individuals better than previous data releases. Because the data release was large and in raw format, news and analytical organizations have yet to publish findings or summaries.

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[1] Food and Agriculture Policy Research Institute (University of Missouri), *Analysis of Stricter Payment Limits: Additional Information*, June 2003, p. 2, at [http://www.fapri.missouri.edu/outreach/publications/2003/FAPRI_UMC_Report_06_03.pdf]; and USDA, *Report of the Commission on the Application of Payment Limitations for Agriculture*, Aug. 2003, pp. 31-39, at [http://www.usda.gov/oce/reports/payment_limits/paymentLimitsAll.pdf].

[2] *Report of the Commission on the Application of Payment Limitations for Agriculture*, pp. 65-75.

Current Payment Limits

Under the 2002 farm bill, the annual payment limit is $360,000 per person. The limit has three parts: $40,000 for direct payments, $65,000 for counter-cyclical payments, and $75,000 for marketing loan gains and loan deficiency payments. These amounts add to $180,000, but can be doubled (see **Table 1**). The $360,000 limit is not a firm ceiling, however. Marketing loan benefits are essentially unlimited because producers can use commodity certificates without limit when other marketing loan options are limited.

One way to double the limit is the "three entity rule," allowing one person to receive payments on up to three entities, with second and third entities eligible for one-half of the limits. The other is the "spouse rule," allowing a husband and wife to be treated as separate persons to double a farm's payment limit. Although payments for most qualifying commodities are combined toward a single limit, separate limits apply to peanuts, wool, mohair, and honey.[3]

The 2002 farm bill also created an income test, prohibiting payments to entities with adjusted gross income greater than $2.5 million, unless 75% or more comes from farming.

Table 1. Payment Limits on Farm Commodity Programs

	Current law	Proposals	
	2002 Farm Bill	S. 385/ H.R. 1590 (109th Congress)	Administration 2006 proposal
Direct and Counter-Cyclical Payments			
(a) Direct Payments	$40,000	$20,000	60,000
(b) Counter-Cyclical Payments	$65,000	$30,000	90,000
Doubling allowance	$105,000	$50,000	None
Subtotal	*$210,000*	*$100,000*	*150,000*
(c) Marketing Loan Payments			
(c1) Marketing Loan Gains plus (c2) Loan Deficiency Payments	$75,000	$75,000	100,000
(c3) Commodity Certificates (c4) Loan Forfeiture Gains	No limit		
Doubling allowance	$75,000	$75,000	None
Subtotal of (c1) and (c2)	*$150,000*	*$150,000*	*100,000*
Subtotal including (c3) and (c4)	*No limit*		
Sum of Direct, Counter-Cyclical, and Marketing Loan Payments			
Total of (a), (b), (c1) and (c2)	*$360,000*	*$250,000*	*250,000*
Total including (c3) and (c4)	*No limit*		

Source: CRS.

[3] See the USDA fact sheet "Payment Eligibility and Limitations" (July 2003), at [http://www.fsa.usda.gov].

How Many Acres Does It Take to Reach the Limit? For cotton and rice, government payments per acre generally are higher, resulting in fewer acres needed to reach the limit. Data from the USDA Payment Limits Commission show that cotton and rice farms can reach the limits with half or fewer of the number of acres of corn, wheat, or soybean farms (**Table 2**). Moreover, cotton and rice farms are usually larger, further increasing the likelihood that they reach the limits. In 2002, 14% of farms harvesting cotton had more than 1,000 acres of cotton, compared with only 2.6% of farms harvesting more than 1,000 acres of corn. Although data in the table do not account for diversified farms growing multiple crops, the results reflect general differences between crops.[4]

How Do Variable Costs Compare? Variable costs per acre to grow cotton and rice usually exceed the variable costs of growing other crops. Cotton and rice groups cite higher variable costs to justify higher government payments per acre. USDA data in **Table 2** show that the ratio of government commodity support divided by variable costs is 164% and 186% for cotton and rice, respectively, compared with 193%, 218% and 259% for corn, wheat, and soybeans, respectively.

Table 2. Acres Needed to Reach Payment Limits, and Support Relative to Variable Costs

Crop	Acres to reach $40,000 direct payment limit	Acres to reach $65,000 counter-cyclical limit	Farms with 1,000 acres or more of crop	Total support divided by variable cost
Corn	1,636	1,497	2.6%	193%
Wheat	2,623	2,956	6.4%	218%
Soybeans	3,565	5,852	3.3%	259%
Upland cotton	1,176	891	14.0%	164%
Rice	416	823	7.8%	186%

Source: USDA Payment Limits Commission (Tables 4.3-4.5), and 2002 Census of Agriculture.

Policy Issues In Congress

Supporters of payment limits use both economic and political arguments to justify tighter limits. Economically, they contend that large or unlimited payments benefit large farms, facilitate consolidation of farms into larger units, raise the price of land, and put smaller, family-sized farming operations at a competitive disadvantage. They say that tighter limits would reduce incentives to expand farms, and facilitate small and beginning farmers in buying and renting land. Politically, they believe that large payments to large farms undermines public support for farm subsidies and is costly to the federal budget.

Critics of payment limits counter that all farms are in need of support, especially when market prices decline, and that larger farms should not be penalized for the economies of size and efficiencies they have achieved. They say that farm payments help

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[4] For more analysis, see also *Farm Level Projections of the Impacts of Payment Limitations*, Agricultural and Food Policy Center (Texas A&M), June 2003, at [http://www.afpc.tamu.edu/pubs/3/402/bp-2003-02.pdf]; and *Analysis of Stricter Payment Limitations*, Food and Agriculture Policy Research Institute (University of Missouri), June 2003, at [http://www.fapri.missouri.edu/outreach/publications/2003/FAPRI_UMC_Report_05_03.pdf].

U.S. agriculture compete in global markets and that income testing is at odds with federal farm policies directed toward improving U.S. agriculture and its competitiveness.

In August 2003, the Payment Limits Commission (created by the 2002 farm bill) provided a detailed report to Congress. The commission was charged to study impacts from tighter limits. The report has extensive data on program payments and limits, but the commission ultimately did not take a position other than that any changes should wait until the next farm bill.

Many observers believe that the 110th Congress may consider payment limits during the 2007 farm bill debate as part of overall consideration of the distribution and effect of subsidies. Several newspapers have published stories critical of farm payments and how they are distributed to large farms, nonfarmers, or landowners.[5] Thus, limits are of increasing interest to many urban lawmakers, and have advocates among smaller farms.

Proposals in the 109th Congress. Senator Grassley introduced S. 385 (109th Congress) to tighten limits on direct, counter-cyclical, and marketing loan payments to a total of $250,000, and count commodity certificates and loan forfeiture toward marketing loan limits. The bill had eight cosponsors. An identical bill, H.R. 1590 (109th Congress), was introduced in the House by Representative Kind and had two cosponsors. Neither of the bills was formally considered by the agriculture committees.

These bills would have reduced the statutory limit (before doubling) on direct payments from $40,000 to $20,000; and the limit on counter-cyclical payments would have decreased from $65,000 to $30,000. While the limit on marketing loans would have remained the same at $75,000, the effective limit would have been reduced because commodity certificates and loan forfeiture would be counted toward the limit (**Table 1**). This is a key feature because, as a practical matter, marketing loan payments are not limited under the 2002 farm bill. When MLGs and LDPs hit the limit, producers can shift to commodity certificates without limit.

The bills would have established a new rule allowing a person with an interest in only a single farming operation to double the payment limits without needing to use the three-entity or spouse rules, both of which would have continued. Thus, farmers would have had another means and found it easier to double the payment limits.

The changes would have applied to the "covered commodities" and to certain loan commodities as a group (wheat, corn, grain sorghum, barley, oats, upland cotton, rice, soybeans, other oilseeds, extra long staple cotton, dry peas, lentils, and chickpeas). But peanuts, wool, mohair, and honey were not addressed by the bills, and thus would have remained eligible for the higher limits enacted in the 2002 farm bill, including unlimited use of commodity certificates and forfeiture.

In February 2005, CBO estimated that a similar plan (but without the provision in S. 385 allowing single farming operations to double the limit) would save $97 million in

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[5] For example, see the Washington Post series *Harvesting Cash*, published in 2006, at [http://www.washingtonpost.com/wp-dyn/content/linkset/2006/07/10/LI2006071000403.html]

FY2006 and $1.2 billion over five years.[6] CBO did not release a specific score of S. 385, but the savings were expected to be less than the figures above because of the single farming operation provision.

In 2005, Congress debated farm bill changes as part of budget reconciliation for FY2006. Neither the House nor the Senate agriculture committee included payment limits in their reconciliation markup.[7] A floor amendment by Senator Grassley to add payment limits to the Senate version of the FY2006 budget reconciliation bill failed by a procedural vote of 46-53 on November 3, 2005 (S.Amdt. 2359 to S. 1932, 109th Congress). S.Amdt. 2359 contained the same monetary limits as S. 385 (109th Congress), but had different provisions regarding attribution and eligibility.

Proposals in the 107th and 108th Congress. In 2003, Senator Grassley introduced similar bill, S. 667 (108th Congress). In 2002, the Senate-passed version of the 2002 farm bill contained tighter limits (S.Amdt. 2826 to S. 1731, 107th Congress), but those limits were rejected by the conference committee. That bill would have limited direct and counter-cyclical payments to a combined $75,000, allowed a $50,000 spouse benefit, replaced the three-entity rule with direct attribution, limited marketing loan benefits to $150,000, and counted commodity certificates and forfeiture. The vote on the Senate's 2002 farm bill amendment was 66-31 in favor of tighter limits.

Administration Proposals. The Administration proposed tighter payment limits in its FY2007 budget request in February 2006. An identical proposal accompanied the FY2006 budget request. The Administration estimated savings of $200 million in FY2007 and $845 million over five years from its payment limits plan.[8] The proposal set a combined cap of $250,000, included commodity certificates and loan forfeiture under the limits, eliminated the three-entity rule, and applied limits to the dairy program (**Table 1**).

Non-Binding Budget Amendments on Payment Limits. In 2005, the Senate-passed budget resolution for FY2006 (S.Con.Res. 18, 109th Congress) contained a non-binding sense of the Senate amendment by Senator Grassley that any agricultural savings should be achieved primarily through reductions in farm commodity program payment limits. This provision was deleted in conference.

For the FY2005 budget resolution (S.Con.Res. 95, 108th Congress), Senator Grassley added an amendment by a 16-6 vote to reduce mandatory agriculture spending by $1.2 billion and increase mandatory conservation, rural development, and child nutrition spending by the same amount. A similar amendment was added to the FY2004 Senate budget resolution (S.Con.Res. 23, 108th Congress). The amendments mentioned in this paragraph did not contain specific reconciliation instructions and would have been nonbinding on the Agriculture Committee.

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[6] Congressional Budget Office, *Budget Options*, "350-02 Mandatory," Feb. 2005, [http://www.cbo.gov/showdoc.cfm?index=6075&sequence=0].

[7] For more on budget reconciliation and the Deficit Reduction Act of 2005 (P.L. 109-171), see CRS Report RS22086, *Agriculture and FY2006 Budget Reconciliation*, by Ralph M. Chite.

[8] Office of Management and Budget, *Major Savings and Reforms in the President's 2007 Budget*, February 2006, pp. 167-170, [http://www.whitehouse.gov/omb/budget/fy2007/pdf/savings.pdf].